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IN THE

Supreme Court of The United States

Spring Term, 1972

No.

WACHOVIA BANK AND TRUST COMPANY,
Petitioner

v.

R. KENNEDY HARRIS, TRUSTEE OF THE ESTATE OF CABANA CLUB APARTMENTS, INC.,
Respondent

IN THE MATTER OF:

CABANA CLUB APARTMENTS, INC.,
Debtor

PETITION OF WACHOVIA BANK AND TRUST COMPANY FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Petitioner, Wachovia Bank and Trust Company (hereinafter "Wachovia"), petitions the Court to grant a Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit affirming the Order of the District Court for the Middle District of North Carolina approving a plan of reorganization for Cabana Club Apartment, Inc. under Chapter X of the Bankruptcy Act.

OPINIONS BELOW

The Decision of the Court of Appeals, by a divided court, decided February 17, 1972, is reported at 455 F 2d 841, and appears in the Appendix to this Petition at pages A2 - A11. The Memorandum Order of the District Court, entered March 4, 1971, which was not reported, appears in the Appendix (A11 - A12). The Report of the Special Master on Hearing for Approval of the Plan of Reorganization, dated January 29, 1970, which was adopted by the District Court in its Memorandum Order, appears in the Appendix (A13 - A52).

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1972, and this Petition for Certiorari was filed within 90 days of that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether a plan of reorganization which defers payment of amounts due to the senior creditor while immediately paying junior creditors in full violates the requirements and limitations of Chapter X of the Bankruptcy Act?

2. Whether a plan of reorganization which adversely affects the rights of the major creditor, a commercial bank, in fundamentally altering its loan from a short-term construction loan to a long-term 20-year loan in violation of the loan agreements between the parties and banking practices and policies of commercial banks is permissible under Chapter X of the Bankruptcy Act?

3. Whether the type of plan and debtor here involved

qualifies as a corporate reorganization within the purposes and function of Chapter X?

4. Whether a plan and the judicial approval thereof which requires the senior creditor to pay to the debtor and junior creditors a sum of money which it never received and does not have, and otherwise acts in a punitive way toward the senior creditor, complies with the fair and equitable requirements of Chapter X of the Bankruptcy Act?

5. Whether the perfunctory adoption by the District Court of the Report of the Special Master without analyzing the plan or reviewing the detailed objections thereto and exercising its independent judgment concerning the plan, complied with the function and duty of the District Court in Chapter X proceedings?

STATUTES INVOLVED

The case involves the application of the provisions of Chapter X of the Bankruptcy Act (United States Code, Title 11, Chapter 10, sections 501-676). The sections in this Chapter which are particularly pertinent to questions presented are Sections 174, 179, 216 (subparagraphs (1) to (7)), and 221 of the Bankruptcy Act (11 U.S.C. §§ 574, 579, 616, 621, respectively), hereinafter set forth:

> "Sec. 174. After the hearing, as provided in section 169 or section 170 of this Act, and, if a plan has been submitted to the Securities and Exchange Commission, as provided in section 172 of this Act, then after the filing of the report or notice that it will not be filed, or after the expiration of the time for its filing, whichever first occurs, the judge shall enter an order approving the plan or plans which in his opinion comply with the provisions of section 216 of this Act, and which are fair and equitable, and feasible, and shall fix a

time within which the creditors and stockholders affected thereby may accept the same.

"Sec. 179. After a plan has been accepted in writing, filed in court, by or on behalf of creditors holding two-thirds in amount of the claims filed and allowed of each class, and, if the debtor has not been found to be insolvent, by or on behalf of stockholders holding the majority of stock, of which proofs have been filed and allowed, of each class, exclusive of creditors or stockholders or of any class of them who are not affected by the plan or whose claims or stock are disqualified pursuant to section 203 of this Act, or for whom payment or protection has been provided as prescribed in paragraphs (7) and (8) of section 216 of this Act, the judge shall fix a hearing, upon notice to the debtor, creditors, stockholders, indenture trustees, the Secretary of the Treasury, the Securities and Exchange Commission, and such other persons as the judge may designate, for the consideration of the confirmation of the plan and of such objections as may be made to the confirmation.

"Sec. 216. A plan of reorganization under this chapter—(1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

(2) may deal with all or any part of the property of the debtor;

(3) shall provide for the payment of all costs and expenses of administration and other allowances which may be approved or made by the judge;

(4) may provide for the rejection of any executory contract except contracts in the public authority;

(5) shall specify what claims, if any, are to be paid in cash in full;

(6) shall specify the creditors or stockholders or any class of them not to be affected by the plan and the provisions, if any, with respect to them;

(7) shall provide for any class of creditors which is affected by and does not accept the plan by the two-thirds majority in amount required under this chapter, adequate protection for the realization by them of the value of their claims against the property dealt with by the plan and affected by such claims, either as provided in the plan or in the order confirming the plan,

(a) by the transfer or sale, or by the retention by the debtor, of such property subject to such claims; or

(b) by a sale of such property free of such claims, at not less than a fair upset price, and the transfer of such claims to the proceeds of such sale; or (c) by appraisal and payment in cash of the value of such claims; or (d) by such method as will, under and consistent with the circumstances of the particular case, equitably and fairly provide such protection;

* * * *

"Sec. 221. The judge shall confirm a plan if satisfied that—(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceedings or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein is equitable, compatible with the interests of the creditors and stockholders and consistent with public policy."

STATEMENT OF THE CASE

1. *Proceedings leading to this Petition*

Cabana Club Apartments, Inc. filed a Petition under Chapter X of the Bankruptcy Act on July 27, 1967. At the outset, Wachovia Bank and Trust Company, which holds 100% of the debts secured by a first lien on Debtor's property and 89% of the total debts of Debtor, filed a Motion to Dismiss, the denial of which was affirmed by the Fourth Circuit on an earlier appeal on the "narrow issue" of whether the Debtor's Petition was filed in good faith in compliance with Chapter X. *Wachovia Bank and Trust Company v. Dameron, Trustee,* 4 Cir., 406 F 2d 803 (decided February 5, 1969). A copy of this Opinion is

included in the Appendix.[1] (A53 - A58)

Subsequently a plan was submitted by the Trustee on July 28, 1969. Objections to the plan were filed by Wachovia (see Section 179 of the Bankruptcy Act, requiring consents of "creditors holding two-thirds in amount of the claims filed and allowed of each class.") The so-called plan of reorganization was approved in a Report filed by the Referee in Bankruptcy sitting as a Special Master. The District Judge in a Memorandum Order entered March 4, 1971, simply adopted the Report of the Referee on the ground that "the Court must accept his findings unless they are clearly erroneous."

On appeal therefrom, a divided Fourth Circuit decided on February 17, 1972, to affirm. The dissenting opinion by Circuit Judge Field takes a sharp issue with the majority decision, adopting the firm position that the plan of reorganization does not comply with the requirements of Chapter X and should not be approved. From the Judgment of affirmance entered by the Fourth Circuit, this Petition for Writ of Certiorari is sought on the grounds that important

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[1] It is very significant that in that earlier appeal, the Fourth Circuit conceded that the rise in the interest rates "foretells a difficulty" in working out a plan, but was unwilling at that time to say that an acceptable plan was "an impossibility." This reference to current interest rates necessarily shows that the court was at that time thinking of a possible refinancing of the project whereby Wachovia would be paid off. In dealing with Wachovia's prediction that the plan likely to be proposed was one deferring payment of its note over the term of 20 years, the Court of Appeals stated: "We do not read the report and the confirming order *so narrowly.*" (Emphasis added) The opinion stressed that the Referee "suggested that Wachovia could be paid in full by arranging other long-term financing." It can thus be seen that the court—far from giving its sanction to the kind of plan which the Trustee has come up with, which involves deferring payment of Wachovia's construction loan over a period of more than 20 years—was thinking in terms of paying Wachovia "in full by arranging other long-term financing."

and far-reaching questions dealing with the function and application of Chapter X of the Federal Bankruptcy Act, as well as the duty and function of a district judge in considering a plan of reorganization, are involved, and that the decision of the Fourth Circuit conflicts with applicable decisions of the Supreme Court, as well as other circuits.

2. *Facts concerning the debtor and the plan of reorganization material to the question here presented*

Debtor is a one-man corporation, owned and managed by Alvin Silverman. Debtor's sole asset and business is the Cabana Club Apartments, an apartment project in Greensboro, North Carolina, which was created in the following manner:

Making a nominal investment himself, Silverman sought to obtain a corporate loan to finance a proposed apartment house project. He secured from Wachovia Bank and Trust Company a commitment for an interim loan to finance construction and, working through Wachovia, secured a commitment from Aetna Life Insurance Company for a long-term loan (sometimes referred to as the "permanent loan") to be used to pay off Wachovia at the completion of construction, which was to take about 9 months. The long-term loan was to be amortized over a period of 20 years. Aetna's commitment was issued October 28, 1965, and Wachovia's commitment was issued March 29, 1966. Several written loan agreements were entered into by Debtor, each explicitly agreeing that Wachovia was putting up the short-term money during construction only and was to be paid off immediately after completion of construction, and Debtor agreed to take the necessary steps to obtain and close a long-term loan from a long-term lending institution for this purpose.

Just prior to commencement of construction a note and

deed of trust in the principal amount of $640,000 were executed, on May 10, 1966, and placed on record; it provided that monthly amortization payments commence April 1, 1967. It was contemplated construction would be completed by this time, whereupon the note and deed of trust were to be assigned by Wachovia to the long-term lender without the necessity of executing and recording a new deed of trust from Debtor to the long-term lender.

Toward the end of construction, in the spring of 1967, after Wachovia had advanced Debtor approximately $632,000 of the $640,000 construction loan commitment, it was discovered that a number of laborers and material suppliers, totalling over $50,000.00, had not been paid by Debtor, in direct violation of the loan agreements. Moreover, because of the existence of the unpaid laborers and material furnishers, who were lienholders or potential lienholders, the title insurance company would not issue a permanent title policy to the long-term lender. Obtaining this title insurance was a fundamental requirement of Aetna Life Insurance Company for closing the long-term loan; and Debtor was unable to come up with title insurance from any source. After exhausting its extensive efforts to get Silverman to come up with the funds to pay off the construction creditors and to arrange for compliance by Debtor with the conditions required to close the permanent loan and thereby repay Wachovia, Wachovia declared a default on the note and deed of trust and accelerated payment of the $632,000 due thereon. Debtor thereupon filed a Chapter X petition.

The so-called plan of reorganization submitted by the Trustee essentially provides (1) that Silverman put up $50,000 to pay in full the unpaid laborers and material furnishers and the 1967 taxes which had never been paid, (2) that the sole asset, the Cabana Club Apartments, be returned to the Debtor and the old management be restored,

and (3) that the payment of the $632,000 construction loan of Wachovia be deferred over a period of at least 20 years.

The undisputed evidence was that Wachovia Bank, the largest bank in North Carolina and in the Southeast, is not in the business of making long-term loans and has never made a long-term "permanent" loan of this kind, that this is against the long-established policy and practice of Wachovia and violates the lending practices of commercial banks, which operate primarily on the basis of demand deposits, and cannot, therefore, properly make loans extending as long as 20 years.

REASONS FOR GRANTING THE WRIT

The basis for seeking a Writ of Certiorari is that the Court of Appeals has incorrectly interpreted and applied Chapter X of the Federal Bankruptcy Act, in conflict with decisions of the Supreme Court and decisions of other Courts of Appeals. The decision below deals with an important question of federal law which will have a far-reaching effect on the use of Chapter X. It will also drastically affect the lending practices and risks of commercial banks and secured creditors for whom the decision below represents a profound change in what had previously been understood to be the rights and risks of the parties.

It is believed, as will be shown in Points 1, 2, and 3, that the decision below conflicts with the decisions of this Court and the other circuits concerning the purpose and application of Chapter X of the Federal Bankruptcy Act to this kind of a situation, but if it is deemed that the questions here raised have not been previously settled, they should by all means be decided at this time. Delineation in this case of limitations on the use of Chapter X to alter and impair the rights of senior creditors and fundamentally

rewrite agreements will be of broad importance to the business community, and will prevent widespread future misuse of Chapter X and the resulting alteration and curtailment of commercial lending and security practices which would follow from the decision below if allowed to stand.

Finally, it is believed, as will be shown in Point 4, that in affirming the manner in which the District Court approached and dealt with the plan of reorganization before it and its perfunctory acceptance of the report of the Referee, without exercising its own independent, analytical, judgment of the plan, the Court of Appeals has so far sanctioned a departure from the accepted and usual course of judicial proceedings in performing the statutory duty of the District Court in considering a Chapter X plan as to call for the exercise of this Court's power of supervision. An amplification of these reasons relied on for the allowance of the Writ as applied to the circumstances of this case is set forth below.

1. Decision of Court of Appeals Approving Plan of Reorganization Violates Chapter X Requirements In Impairing Rights of Senior Creditors While Paying Junior Creditors in Full

The plan of reorganization which has thus far received a judicial seal of approval provides for the immediate, full, and certain payment to the junior creditors but deferred and uncertain payment to the senior creditor. It provides that the Class B and the Class C junior creditors shall be paid in full in cash immediately upon confirmation of the plan whereas the non-accepting senior, Class A, creditor, holding almost 90% of the total debt, is not to be paid in full for at least 20 years. Moreover, the plan fails to make any provision for the immediate payment of the existing arrearage of 13 months of unpaid principal

payments now due Wachovia (see Point 3b, *infra*), even if it were in fact proper to pay Wachovia "according to the terms of the note and deed of trust" as the plan purports—but fails—to do. The result is that junior creditors are receiving immediate full payment of everything owed them *before* any payment of *past due* amounts owed the senior creditor. In addition, the plan changes the entire nature of the short term loan of Wachovia required to be repaid in full at the end of construction in April, 1967, and defers payment over at least 20 years of an obligation already due in full under the express terms of the written loan agreements between Debtor and Wachovia (even apart from the acceleration of the note caused by Debtor's defaults).

In *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414 88 S. Ct. 1157 20 L. Ed. 2d 1 (1968), this Court unequivocably declared:

> "Under §§ 174, 221 (2) of Chapter X, 52 Stat. 891, 897, 11 U.S.C. §§ 574, 621 (2), a bankruptcy court is not to approve or confirm a plan of reorganization unless it is found to be 'fair and equitable.' This standard incorporates the *absolute priority* doctrine under which creditors and stockholders may participate *only in accordance with their respective priorities.* . . . participation by junior interests depends upon the claims of senior interests being *fully* satisfied. . . ."[2]

United States v. Key, 397 U.S. 322, 90 S. Ct. 1049, 25 L. Ed. 2d 340 (1970) recently held that neither Section 216 (7) and 221 nor the special statute applying to Government claims (which was viewed as consistent with the

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[2] Emphasis in this quotation and the others in this Petition has been added.

approach of Chapter X) permit a plan providing for immediate, although partial, payment to junior creditors simultaneously with immediate, partial payment to the senior creditor and deferred payment of the balance of the senior creditor's claim. The Opinion states:

> "This Court has long held that these words, along with the words 'fair and equitable' in § 221, in no way authorize a District Court to ignore or erode priorities otherwise granted by law, . . . In short, the words 'fair and equitable' in Chapter X are terms of art, and no plan can be 'fair and equitable' which compromises the rights of senior creditors in order to protect junior creditors. . . ."

Marine Harbor Properties v. Manufacturer's Trust Co. 317 U.S. 78, 63 S. Ct. 93, 87 L. E. 64 (1942) held:

> "Approval of the petition on the grounds advanced by the District Court could be made only under the composition theory of reorganization, which chap. X, like § 77B, rejected in favor of the *full priority* rule of the Boyd Case . . . . *That rule protects the rights of senior creditors* against dilution either by junior creditors or by equity interests. . . ."

S.E.C. v. Crumpton Builders, Inc., 5 Cir., 337 F 2d 907, (1964), stated that the fair and equitable "rule would require that a plan of reorganization reduce the claims of investors on a strict priority basis; junior interests would have to be scaled down *before* senior interests could be reduced. . ."

The plan under review squarely contravenes this rule in not providing for immediate payment of amounts due the senior creditor while providing for immediate payment in full of junior creditors, and in failing to give adequate

recognition to the priorities and rights as between senior and junior creditors, and as between the creditors and the sole stockholder of the Debtor, to whom the plan proposes to return the sole asset. The majority opinion of the Fourth Circuit misapplies Chapter X and conflicts with the foregoing decisions.[3]

2. The Plan Does Not Accomplish a Legitimate Corporate Reorganization Contemplated by Chapter X

This is not the type of corporate organization for which Chapter X was designed. As stated in *John-Hancock Mutual Insurance Co. v. Casey,* 1 Cir., 141 F 2d 104, *cert. den.* 323 U.S. 713, 65 S. Ct. 39, 89 L. Ed. 574 (1944):

> "Chapter X was intended to be 'unavailable to corporations having simple debt and capital structures whose only purpose in resorting to the organization procedure is to gain by delay temporary advantages for the old management.' Gerdes, Corporate Reorganizations (1938) 52 Harv. L. Rev. 1, 5."

This principle precisely applies to this Debtor—a one-man, real estate holding corporation, owning a single asset—an apartment project, having the simplest kind of capital and debt structure and no public investors; and to this plan—which has accomplished nothing except to give the old management five years' delay in coming up with the money

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[3] In his dissenting opinion in the case at bar (A8-A11), Judge Field aptly stated:

> ". . . It has long been recognized that the words 'fair and equitable' are words of art, and in my opinion any plan that in effect compromises the rights of a senior creditor to accommodate junior creditors does not comport with the statutory standards. *United States v. Key,* 397 U.S. 332 (1969); *Case v. Los Angeles Lumber Co.,* 308 U.S. 106 (1939)."

to pay the unpaid laborers and material furnishers required by the loan agreements to be paid prior to and as a part of completion of construction, as an express and basic condition of the long-term loan.

In *S.E.C. v. American Trailer Rentals Co.,* 379 U.S. 594, 85 S. Ct. 513, 13 L. Ed. 2d 510 (1965), in reversing the District Judge's order in which he "accepted and adopted" the Referee's findings and report, the Supreme Court expressly relied upon an earlier decision in which:

> " . . the Court recognized that "in general . . . the two chapters were specifically devised to afford different procedures, the one [Chapter X] adapted to the reorganization of corporations with complicated debt structures and many stockholders, the other [Chapter XI] to composition of debts of small individual business and corporations with few stockholders . . .' 310 U.S. at 447, 84 L. Ed. at 1299. . .
>
> "'The basic assumption of Chapter X and other acts administered by the Commission is that the investing public dissociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud, and in the understanding of complex financial problems.' Id. 310 U.S. at 448 - 449, note 6, 84 L. Ed. at 1300."

The *American Trailer Rentals* opinion goes on to say:

> ". . . It seems clear that in enacting Chapter X Congress had the protection of public investors, and not trade creditors, primarily in mind. . . .
>
> "On the other hand, General Stores also makes it clear that even though there may be no public debt materially and directly affected, Chapter X is still the appropriate proceeding where the debtor has widespread

> public stockholders and the protections by Chapter X are required because, for example, there is evidence of management misdeeds for which an accounting might be made, there is a need for new management, or the financial condition of the debtor requires more than a simple composition of its unsecured debts."

Accord: *S.E.C. v. Crumpton Builders, Inc.,* 5 Cir., 337 F 2d 907 (1968). None of these occasions for Chapter X intervention is present. There are no public stockholders or public debt. The plan proposes a return to the same old management. The plan has not even gone so far as to effect a simple composition of the unsecured debts; it merely provides that the junior creditors shall be paid in full and that Debtor should come up with a sum of money to do this.

The net result of this entire costly Chapter X proceeding and the so-called plan which does not reorganize anything has simply been to give the Debtor five years to raise $50,000 to finish paying the construction creditors, which Wachovia tried repeatedly and unsuccessfully to get it to do in the spring of 1967 when these debts became due, in order to meet the requirements for closing the long-term loan from Aetna before Aetna's commitment expired. This is not a legitimate function of a Chapter X plan. *Lincoln-Alliance Bank & Trust Co. v. Dye,* 2 Cir., 115 F 2d 234 (1940) declared that a plan "must certainly contain more than holding him [the mortgagee] off at the mortgagor's convenience. Chapter X, 11 U.S.C.A. § 501, et seq., was not intended merely to give mortgagors a moratorium upon foreclosure." It is apparent that all this debtor has done is to buy more time at the expense of his creditors "solely on the basis of the speculative hopes and wishful thinking of those having nothing to lose and everything to gain if the speculation turns out to be a success." *Caplan v. Anderson,* 5 Cir., 256 F 2d 416 (1958).

In *Arey & Russell Lumber Co. v. American National Bank & Trust Co. of Danville, Virginia,* 4 Cir., 201 F 2d 508 (1953) the debt to the bank was secured by a deed of trust on the borrower's plant, and the bank had advertised for sale under this deed of trust, whereupon the debtor filed a petition for an arrangement under Chapter XII of the Bankruptcy Act, which specifically deals with relief involving real property; this was dismissed because debtor was a corporation. Then the debtor filed a petition under Chapter X. In dismissing the Chapter X proceeding the Court held:

> "The manifest purpose of the filing was to obtain just such an extension of the indebtedness secured by the deed of trust as had been sought in the Chapter XII proceeding and which Congress had seen fit to deny to corporate debtors. Since the entire secured indebtedness was held by a single creditor that had clearly indicated that it would not grant any extension, it was unreasonable to expect that a plan of reorganization could be effected. 11 U.S.C.A. § 546 (3)."

Thus it can be seen that the decision of the majority in the instant case in permitting the use of Chapter X for this situation and purpose, for which it was never intended, conflicts with the uniform holdings of the Supreme Court and the various circuit courts.

3. In Violation of Sections 174, 179, and 216 of the Bankruptcy Act, the Plan Approved by the Courts Below Adversely Affects Rights of the Senior, Majority Creditor

a. *The bank's short-term construction loan has been converted into an entirely different and unprecedented obligation*

In contradiction of the statement in the plan approved by courts below and in the report of the Special Master adopted by the Judge that Wachovia Bank is "not affected by the plan," the proposed plan drastically affects the rights of the bank inasmuch as it converts a temporary construction loan made by the bank into a long-term loan not made by the bank, in flagrant violation of the unquestioned intention and agreement of the parties, and contrary to necessary commercial banking policy. The loan documents which govern the entire financing of the apartment project plainly and repeatedly provide that the bank's loan was only an interim advance during the construction period of less than a year, and not a long-term 20-year loan, which the bank never intended or agreed to make and which it is not in the business of making. The evidence which was undisputed, was that, for very sound reasons, *Wachovia, being a commercial banking institution dependent upon demand deposits, does not, and cannot consistent with sound commercial banking policy and practice, make long-term 20-year loans.*

There can be no doubt, and indeed the Courts below acknowledge that the bank's loan was to provide construction funds only, and that it was intended and agreed that Aetna, not Wachovia, was to provide the permanent financing, and that Debtor would meet the plainly prescribed conditions to accomplish this. As stated in the Dissenting Opinion below, the effect of this plan is to "enlist the services of the court in a Chapter X proceeding to rewrite the entire series of financing agreements to which the debtor was a party, and force Wachovia into the posture of a long-term lender which plainly was not contemplated by the parties."

It was held in *Lincoln-Alliance Bank and Trust Co. v. Dye*, 2 Cir., 115 F 2d 234 (1940), (Judges L. Hand, Swan,

and A. Hand) dealing with Chapter X, that: "the four possibilities left to the debtor in such a case are in fact scarcely more than ways, either of paying off the lien, or of not affecting the substance of the lienor's rights." It cannot be properly said that the substance of the rights of the senior creditor under the loan agreements is not affected by the plan (Sec. 179) or that it "equitably and fairly" protects Wachovia (Sec. 216), inasmuch as the plan admittedly attempts to extend and convert the loan which the senior creditor agreed to make, for the period of construction only, to a fundamentally different kind of loan and risk, lasting for more than 20 years.

It cannot be stressed too strongly how serious and far reaching is the effect of the approval by the courts below of such a result and such a plan upon the present and future lending policies and practices not merely of Wachovia Bank, but of other commercial bank lending institutions. It is because of the major principle involved and the sweeping and disruptive result of the action appealed from that Petitioner has been so assiduous in urging its objections to the basic approach taken in the bankruptcy court below, which it is submitted, violates a basic premise of Chapter X.

b. *Failure to pay Wachovia the principal arrearage*

Even if the bankruptcy court could legally force a conversion of Wachovia's construction loan into a long-term loan, the plan does not even accomplish what it purports to do, i.e., pay Wachovia "in accordance with the tenor of its note secured by a first lien deed of trust."

The note and deed of trust required that the principal be curtailed by equal monthly payments of $4,586.67 beginning April 1, 1967, to be paid in full by March 1, 1987. No payments whatsoever for the months of April, May, June, July, August, and September of 1967 were made by the Debtor. In October, 1967, the court ordered the trustee

to begin paying $4,586.67 to Wachovia each month, as an interim measure, until a plan could be developed, without prejudice to Wachovia's position and rights. The initial interim payments were applied first to the interest in arrears which had been accumulating and was unpaid, with the result that the interim payments made by the trustee under court order in the month of October, 1967 through May, 1968, were applied entirely to unpaid back interest. It was not until June of 1968, *more than a year* after April 1, 1967, when amortization of the principal was required to begin, that any amount was able to be applied to principal. This existing deficit in the loan account has not been made up. The proposed plan makes no provision to pay this principal arrearage, nor are there any funds available to do this.

Wachovia has, therefore, been deprived of 13 back principal payments, and if, in fact, payment had been made to Wachovia "in accordance with the terms and provisions" of the long-term loan, it would have approximately $20,000 more today than it does have, on which it could be earning a return. It is thus manifest that the plan adversely affects the rights of the senior and majority creditor, is not "fair and equitable," and pays junior creditors in full before paying the senior creditor even the amounts past due. Without its consent, therefore, the plan cannot be approved under Chapter X.

As held by the Second Circuit in *In re Murel Holding Corp.*, 2 Cir., 75 F 2d 94 (1935):

> "it is plain that 'adequate protection' must be completely compensatory; and *that payment ten years hence is not generally the equivalent of payment now.* Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will

> scarcely be content with that; he wishes to get his money or at least the property."

The Fourth Circuit itself in *Leas v. Courtney Co.*, 4 Cir., 261 F 2d 13 (1958) ruled that "the secured debt *will be* materially affected" by a proposal *"to extend the time of repayment."*

The erroneous position taken in the decision below is that "Wachovia will, under the plan, be paid in full in twenty years. It has no right to more."[4] This totally misses the point here urged: *Even if* this deficiency and principal arrearage were somehow made over a period of 20 years (even though no provision whatsoever is made for this in the plan) or at the end of the 20-year period by a balloon payment, this will not change the inescapable fact that the lender will have been deprived for many months and years of the existing principal arrearage which is currently past due—which money it would have already received and had the use of, if payments "in accordance with the terms of the note and deed of trust" had been made. This squarely violates the Chapter X rule that "payment ten years hence is not generally the equivalent of payment now" (*In re Murel*, 2 Cir., 75 F 2d 94) and that a plan which will "extend the time of repayment" causes the secured debt

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[4] Likewise, the assertion in the majority opinion that the plan "required that Wachovia be repaid, over a twenty-year period, the total sum of $1,087,040.00, while the principal amount of its loan with 6% interest on the declining balance over a like period would total $1,087,932.00" (which figure, incidentally, came directly from an unsupported statement in respondent's brief and is not to be found anywhere in the record) fails to meet the crucial point made in the text. It also does not add up. By March 1, 1987, when the note and deed of trust require repayment to have been completed, the contemplated continuance of the $4,586.67 monthly payments will have resulted in the payment of only $1,073,280.78 (234 monthly payments x $4,586.67), falling $14,651.00 short of the court's own figure.

to be "materially affected" (*Leas v. Courtney*, 4 Cir., 261 F 2d 13).

c. *Wachovia has been unfairly and unjustifiably ordered to pay to the Debtor a fee which Wachovia did not receive and does not have.*

In the words of Judge Fields in his dissenting opinion, "the ultimate inequity in the plan," and hence in the action of the courts below, is that Wachovia has been ordered to pay to the Debtor (as a necessary part of funding the plan) a commitment fee of $6,400.00 which was paid, not to Wachovia, but to the proposed long-term lender, Aetna Life Insurance Company to cover its expenses, and belongs solely to that company. To force Wachovia to pay such money to Debtor out of its own pocket as a part of the "plan of reorganization" clearly violates the "fair and equitable" requirement of sections 174 and 216. It amounts to an unlawful seizure by the courts. As stated by Judge Fields below: "In my opinion, there is no justifiable basis in law or in fact to summarily tax this item to Wachovia as an incident to the plan."

The majority opinion concedes that this money "was remitted to Aetna" but then rules that "Wachovia should refund the fee so as to make it a resource for payment of all of Cabana's debts." The only attempted justification of this arbitrary action truly smacks of the assessment of a penalty against Wachovia for taking steps to insist upon compliance by the Debtor with the terms of his loan agreement.[5] There is no provision in Chapter X authorizing this

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[5] As stated by the Dissent below:
"The majority repeatedly emphasizes that Wachovia in effect should be penalized for its failure to make a formal tender of the loan to Aetna since under the Buy-and-Sell Agreement Aetna had the option to purchase the loan even though less than all of the con-

kind of punitive action toward a creditor. Can there be any question that the plan is not "fair and equitable" to Wachovia and does "adversely affect" its rights?

4. District Court and Circuit Court Misconstrued the Role of the District Judge in Passing upon Plan of Reorganization Under Chapter X

The Memorandum Order of the District Court states: "In reviewing the findings of fact of the Referee, the court must accept his findings unless they are clearly erroneous . . . it is determined that the findings of fact and conclusions of law of the Referee are neither arbitrary nor clearly erroneous, and the Court adopts the same for the purpose of approving the plan of reorganization submitted by the trustee." Then, without anlayzing or discussing the plan or the findings of the Referee, or considering any of the numerous and detailed objections to the plan and to the findings raised by Wachovia, the District Judge perfunctorily approved the plan. See Memorandum Order in Appendix. (A11 - A12)

TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 88 S. Ct. 1157, 20 L. Ed. 2d 1 (1968) governs this aspect. Reviewing an order of the District Court in a Chapter X proceeding, including findings that certain features of the plan "are fair and equitable," the Supreme Court referred to the

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ditions had been met by the borrower. To seize upon this as the premise for such punitive treatment of Wachovia is utterly unrealistic. In its course of business with Aetna over a long period of years, Wachovia was well aware of the fact that Aetna would not accept the loan with the claims of the materialmen and construction lien holders outstanding and unpaid. Under these circumstances a formal tender of the loan by Wachovia to Aetna would have been a useless act. Certainly it is obvious that if there was any way possible to close the Aetna transaction, Wachovia would have done so and thereby obtained repayment of its construction loan."

"perfunctory, almost offhand manner in which the Court accepted" the recommendations of the trustee, and stated:

> "If the quoted statement of the trial court had been the result of an adequate and intelligent consideration of the merits of the claims, the difficulties of pursuing them, the potential harm to the debtor's estate caused by delay, and the fairness of the terms of settlement, then it would without question have been justifiable to approve the proposed compromises. *It is essential, however, that a reviewing court have some basis for distinguishing between well-reasoned conclusions arrived at after a comprehensive consideration of all relevant factors, and mere boiler-plate approval phrased in appropriate language but unsupported by evaluation of the facts or analysis of the law.*"

The Court emphasized that "it is essential that every important determination in reorganization proceedings receive the 'informed, independent judgment' of the bankruptcy court." The District Court's manner of considering and dealing with the instant Chapter X plan fails to meet the standards plainly set by this Court in *TMT Trailer Ferry*. Indeed it is remarkable how closely the Court came in the quoted passage to describing the order of the District Court here on review.

What Wachovia is attacking is the legality of the proposed plan. The "clearly erroneous" rule does not protect the Referee's approval of a plan (1) which impairs and postpones payments of amounts owing to the senior creditor while paying the junior creditors in full, (2) which adversely affects the rights of the senior, majority creditor without its consent, and is not fair and equitable, and (3) which does not accomplish a legitimate corporate reorganization contemplated by Chapter X.

In *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 60 S. Ct. 1, 84 L. Ed. 110 (1939) after speaking of the District Court's duty in reorganization proceedings to render "an informed, independent judgment" on each important determination, the Supreme Court passed upon "the question of law as to whether on these facts the plan was fair and equitable within the meaning of § 77B [now Chapter X]," and held:

> "on that question of law we think that the District Court erred in confirming the plan and that the Circuit Court of Appeals erred in affirming that decree. We think that as a matter of law the plan was not fair and equitable."

CONCLUSION

For these reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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May 5, 1972